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ADVANCED DESIGN REPORT DEFINED BENEFIT PLANS

IF YOU'RE THE SOLE PROPRIETOR OF a small business, you probably know that you've got some terrific options to choose from when it comes to setting up a tax-advantaged retirement account. But here's one you might not have thought of: a solo defined-benefit plan. These traditional pension plans have been around for years, but get relatively little attention compared with other retirement-savings plans. This shouldn't be the case, however, since solo DB plans allow people to contribute perhaps \$100,000 *a year*.

The generous contribution limits make these plans worth serious consideration by people who are late to the retirement savings game *and* who are prepared to set aside serious dollars to make up for lost time. Sound familiar? Here's what you need to know.

Defined-Benefit Pension Plans. These are the traditional pension plan arrangements that were common years ago but have fallen out of favor — except for some large employers and labor unions. With a DB plan, annual deductible contributions are mandatory — at least until the plan becomes fully funded, which can take years.

The annual amount that must be contributed to your DB account is determined by complicated actuarial calculations. (More on that later.) What's important to understand first is that the best candidates for solo DB plans are high-income folks (say \$100,000 or more) who are approaching middle-age or older (say 45 and above). Also, you must expect to have plenty of cash during the next few years that you would be willing to pump into your retirement plan. If you don't fit this profile, you can stop reading right now, because a DB plan isn't for you. (A DC plan like a [Solo 401\(k\)](#) is what you need.) But if you do fit the profile, you'll like the rest of this story.

Defined-Benefit Plans Mean Big Deductible Contributions

If you set up a solo DB plan, it will be designed to pay out a "target" level of annual benefits from your account after you reach the retirement age stipulated in the plan document. The target benefit can be based on:

A fixed percentage of your average salary or self-employment income over your entire career with your small business, or over a certain number of years near the end of your working life.

A flat monthly dollar amount.

A formula based on years of service in your small business.

You (if you are self-employed) or your company (if you are employed by your own corporation) will make annual deductible contributions to your account in amounts calculated to be sufficient to fund the target level of retirement benefits. Of course, the bigger the target benefit, the more money must be pumped into your account to get it fully funded before you hit retirement age. In any case, the maximum annual target benefit that can be funded for the 2007 tax year is \$180,000 (adjusted annually for inflation). To be honest, this limitation is so big, it doesn't come close to preventing large annual deductible contributions to your DB plan.

For example, a 55-year-old self-employed person earning \$100,000 might be able to contribute and deduct that entire amount for several years. As a threshold, figure on at least five years of contributions averaging at least \$60,000. Bring your checkbook! This strategy is not for the fainthearted. (In contrast, the maximum 2007 contribution to a solo 401(k) plan would be "only" \$40,500, if you earn \$100,000.)

Bottom Line: The very fact that a DB plan permits large annual contributions is its key selling point, because these contributions are deductible. That means Uncle Sam is subsidizing you to supercharge your tax-favored retirement fund.

Solo DB Plans Are the Next Big Thing

Defined-benefit pension plans have been around for many years. But they are complicated creatures that require a customized plan document, annual actuarial calculations, and a yearly report to the IRS once the plan is worth over \$100,000. For these reasons, DB plans of the past were not terribly well suited to one-person businesses — although they have always been used by a relatively few well-heeled small-business owners.

Things change. Now, there are a number of outfits that are ready and willing to help you establish and operate a one-person DB plan at an affordable cost. Solo DB plans are going mainstream.

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